

April 3, 2006

Ms. Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

Dear Ms. Rupp:

We are writing in response to NCUA's advance notice of proposed rulemaking regarding the Supervisory Committee Audits. As requested, we will identify and respond to each question below.

Question No.

1. Should part 715 require, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting above a certain minimum asset size threshold? Explain why or why not.

Response: Due to the unique and limited nature of credit unions, we do not feel an attestation on internal controls over financial reporting is necessary. The fundamental difference between for-profit public companies and not-for-profit companies makes credit unions inherently less-risky as they have a reduced incentive to misstate financial statements. With no stock-holders to report to and no market pressure, credit unions have less of a need to falsify its numbers. In addition, the unnecessary cost will burden rather than benefit the general membership of credit unions.

2. What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting, given the additional burden on management and its external auditor? Explain the reasons for the threshold you favor.

Response: As stated previously, we are of the opinion that attestation of internal controls for credit unions should not be mandated. If an internal control attestation was required, complexity and size of the institution should be evaluated to determine the threshold. It should at a minimum be comparable to FDIC's \$1 billion in assets threshold.

3. Should the minimum asset size threshold for requiring an "attestation on internal controls" over financial reporting be the same for natural person credit unions and corporate credit unions? Explain why.

Response: Yes, if required, consistency should be set; thus, the minimum threshold should be the same for both natural person and corporate credit unions.

4. Should management's assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting, (i.e., financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes), or should it be more narrowly framed to cover only certain types of financial reporting? If so, which types?

Response: Management's assessments of the effectiveness of internal controls and the attestation by its external auditor should cover only reports prepared for regulatory purposes if implemented for the reasons given earlier (i.e. call reports). Since call reports must comply with GAAP for credit unions with assets exceeding \$10 million, the attestation of the call reports would essentially cover financial statement reporting as well.

5. Should the same auditor be permitted to perform both the financial statement audit and the "attestation on internal controls" over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the "attestation on internal controls?" Explain the reasons for your answer.

Response: Most importantly, the freedom to engage one or more auditors to perform the financial statement audit and the attestation on internal controls should be bestowed to credit unions. Utilizing one auditor may maximize efficiency and allow for a better understanding of the control environment. As long as the auditor is independent, having one auditor perform both functions will not diminish the validity.

6. If an "attestation on internal controls" were required of credit unions, should it be required annually or less frequently? Why?

Response: After an initial attestation is performed, we believe an attestation should be performed every other year, unless there are significant changes at the credit union.

7. If an "attestation on internal controls" were required of credit unions, when should the requirement become effective (i.e., in the fiscal period beginning after December 15 of what year)?

Response: Due to the massive amount of documentation and work required by SOX, we believe a minimal time of 36 months would be needed to satisfy the requirements. Thus, three years after the final ruling, including SEC's finalization of the requirements for public companies, is suggested.

#### B. Standards Governing Internal Control Assessments and Attestations

Management's responsibility in an "attestation on internal controls"—to report its assessments of the effectiveness of the internal control structure and procedures established and maintained by the credit union—and the external auditor's responsibility—to examine, attest to, and report on management's assessments—each must be done in accordance with a standard recognized by the auditing industry. For management, the most commonly recognized standard for

establishing, maintaining and assessing the effectiveness of the internal control structure is the Internal Control – Integrated Framework (1994 ed.) developed by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). For the external auditor’s attestation, the standard for non-public companies thus far has been the American Institute of Certified Public Accountants (“AICPA”) AT 501 internal control attestation standard.

The AICPA has exposed for public comment a revised AT 501 that is more in line with the Public Company Accounting Oversight Board’s (“PCAOB”) Auditing Standard No. 2 (“AS 2”) that applies to public companies under Sarbanes-Oxley, 15 U.S.C. 7262(b). The final revisions to AT 501 are likely to require greater documentation and testing of internal control over financial reporting by management to enable the auditor to fulfill the attestation responsibility.<sup>3</sup>

To assist the NCUA Board in determining what assessment and attestation standards should apply to credit union “attestation on internal controls” engagements, please comment in response to the following questions:

8. If credit unions were required to obtain an “attestation on internal controls,” should part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB’s AS 2 standard that applies to public companies, or to the AICPA’s revised AT 501 standard that applies to non-public companies? Please explain your preference.

Response: If required, since credit unions are not public companies, the AICPA’s revised AT 501 standard would be more appropriate.

9. Should NCUA mandate COSO’s Internal Control – Integrated Framework as the standard all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?

Response: To promote consistency, NCUA should develop a common standard for credit unions to follow. However, using the COSO framework may be overly burdensome, as it was developed for public companies.

#### C. Qualifications of Supervisory Committee Members

A credit union’s Supervisory Committee is appointed by its board of directors and “shall consist of not less than three members nor more than five, one of whom may be a director other than the compensated officer of the board.” 12 U.S.C. 1761(b). Further, “no member of the credit committee, if applicable, or any employee of th[e] credit union may be appointed to the committee.” NCUA, Federal Credit Union Standard ByLaws Art. IX, §1 (Rev. 10/99), 65 FR 55760 (Oct. 14, 1999). See also 70 FR 40924, 40928 (July 15, 2005). Apart from these disqualifications based on position and not asset size, part 715 imposes no affirmative qualifications as a prerequisite to serve on a Supervisory Committee.

For financial institutions other than credit unions, the audit committee is the analog to a credit union Supervisory Committee. For institutions with total assets of \$1 billion or more, FDIC requires the audit committee to be comprised completely of members who are independent of management of the institution. 12 C.F.R. 363.5(a)(1). If this limitation were to apply to Supervisory Committees, 103 natural person and 17 corporate credit unions would be affected. For institutions with total assets of \$500 million or more but less than \$1 billion, FDIC requires the majority of the members of the audit committee to be independent of management of the institution. 12 C.F.R. 363.5(a)(2). If this limitation were to apply to Supervisory Committees, 258 natural person and 22 corporate credit unions would be affected. Exceptions to these restrictions are permitted when it imposes a hardship in recruiting and retaining competent members. Id.

Finally, for institutions with total assets of more than \$3 billion, FDIC requires audit committee members to have banking or related financial management expertise, access to their own outside counsel, and no association with any large customer of the institution. 12 C.F.R. 363.5(b). If the asset threshold for these qualifications were to apply to Supervisory Committees, 12 natural person and 6 corporate credit unions would be affected. To assist the NCUA Board in determining whether to develop such qualifications as prerequisites for Supervisory Committee membership, please respond to the following questions:

10. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in credit union, banking or other financial matters? If so, what criteria should they be required to meet and what should the minimum asset size threshold be?

Response: Again, depending on the complexity and size of the credit union, it should have a certain level of expertise. Supervisory committee members of credit unions greater than \$100 million should require banking or related financial management expertise.

11. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel? If so, at what minimum asset size threshold?

Response: We believe that it could be detrimental to the inner workings of credit unions if NCUA stipulated that Supervisory Committees were allotted access to their own legal counsel. When a need to seek legal counsel arises, agreement to this need should be sought from management, the Board and Directors and the Supervisory Committee. This process should not be governed by a regulatory body.

12. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor? If so, at what minimum asset size threshold?

Response: We see no threat with Supervisory Committee members being associated with large customers of the credit union. Supervisory Committee members by their very nature are an oversight committee, and not involved in making decisions (e.g. loan granting, pricing, etc.).

13. If any of the qualifications addressed in questions 10, 11 and 12 above were required of Supervisory Committee members, would credit unions have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers? If so, describe the obstacles associated with each qualification.

Response: No, we do not believe recruiting members with a financial background or related field would be that difficult.

D. Independence of State-Licensed, Compensated Auditors

Under existing part 715, a financial statement audit of a federally-insured credit union must be “performed in accordance with GAAS by an independent person who is [State-licensed].” 12 C.F.R. 715.5(a). GAAS incorporates the AICPA “independence” standards that apply when an independent, licensed certified public accountant audits financial statements. 12 C.F.R. 715.2(f). FDIC requires independent accountants who audit institutions with assets of \$500 million or more to not only meet the AICPA’s Code of Professional Conduct, but also to meet the “independence” standards and interpretations of the U.S. Securities and Exchange Commission (“SEC”) and its staff.<sup>4</sup>

12 C.F.R. 363 App. A ¶14. To assist the NCUA Board in determining what “independence” standards should apply to State-licensed, compensated auditors, please comment in response to the following question:

14. Should a State-licensed, compensated auditor who performs a financial statement audit and/or “internal control attestation” be required to meet just the AICPA’s “independence” standards, or should they be required to also meet SEC’s “independence” requirements and interpretations? If not both, why not?

Response: Since credit unions are not public entities, AICPA standards are adequate.

E. Audit Options, Reports and Engagements

Experience with part 715 over the last six years has raised a number of miscellaneous issues. To assist the NCUA Board in addressing these issues, please respond to the following questions:

15. Is there value in retaining the “balance sheet audit” in existing §715.7(a) as an audit option for credit unions with less than \$500 million in assets?

Response: We believe the threshold for balance sheet audits should be reduced to credit unions with assets greater than \$100 million.

16. Is there value in retaining the “*Supervisory Committee Guide* audit” in existing §715.7(c) as an audit option for credit unions with less than \$500 million in assets?

Response: We believe the threshold for audit options (balance sheet, or agreed upon procedures) should be reduced to only credit unions with assets of less than \$100 million.

17. Should part 715 require credit unions that obtain a financial statement audit and/or an “attestation on internal controls” (whether as required or voluntarily) to forward a copy of the auditor’s report to NCUA? If so, how soon after the audit period-end? If not, why not?

Response: 90 days.

18. Should part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union? If so, how soon after the credit union receives it? If not, why not?

Response: 90 days.

19. If credit unions were required to forward external auditors’ reports to NCUA, should part 715 require the auditor to review those reports with the Supervisory Committee before forwarding them to NCUA?

Response: Yes

20. Existing part 715 requires a credit union’s engagement letter to prescribe a target date of 120 days after the audit period-end for delivery of the audit report. Should this period be extended or shortened? What sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?

Response: 120 days is reasonable. Monetary penalties would also be reasonable.

21. Should part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor’s dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons for the dismissal or resignation?

Response: Yes.

22. NCUA recently joined in the final Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters, 71 FR 6847 (Feb. 9, 2006). Should credit union Supervisory Committees be prohibited by regulation from executing engagement letters that contain language limiting various forms of auditor liability to the credit union? Should Supervisory Committees be prohibited from waiving the auditor’s punitive damages liability?

Response: No.

Thank you for offering us the opportunity to respond to the letter. We hope our comments will be helpful. Please do not hesitate to contact us with any questions or comments.

Best regards,

Ken Burns, President/CEO

Via e-mail